[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 2298
ENTERPRISE ZONE TAX ACT OF 1982

SCHEDULED FOR HEARINGS

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

SENATE COMMITTEE ON FINANCE

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INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled public hearings on April 15 and 16, 1982, on S. 2298, the Enterprise Zone Tax Act of 1982 (introduced by Senators Chafee, Heinz, Grassley, Matsunaga and others). This bill is the Administration's proposal to provide tax and other incentives in designated zones in economically distressed areas.

This pamphlet, prepared in connection with the hearings on S. 2298, contains descriptions of the various provisions of the bill. Accompanying each description is a summary of the related provisions of present law. The bill contains four titles: Title I—designation of enterprise zones; title II—tax incentive provisions; title III—regulatory flexibility; and title IV—establishment of foreign trade zones in enterprise zones.

The first part of the pamphlet is a summary of the bill. This is followed in the second part with the description of the provisions of the bill. The third part presents the Administration's estimates of the revenue effects of the bill. An Appendix provides a summary description of area eligibility criteria for Urban Development Action Grants (UDAG).

The Subcommittee previously held hearings on a related bill, S. 1310 (Urban Jobs and Enterprise Zone Act) on July 13 and 16, 1981. A description of S. 1310 is contained in a prior Joint Committee staff pamphlet (JCS–33–81; July 10, 1981).

I. SUMMARY

Present Law

Targeted area

The Internal Revenue Code generally does not contain rules for targeting areas for special tax treatment. However, Code section 103A, relating to mortgage subsidy bonds, defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of its employees. Prior law contained the new jobs credit, which provided a tax credit, for 1977 and 1978, based on the increase in the employer's payroll over that of the prior year. Under present law, the targeted jobs tax credit provides a tax credit for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education or rehabilitation program, and economic status.

Tax credit for employees

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of his employment. The earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Investment tax credit

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. In addition, the credit applies to expenditures to rehabilitate industrial and commercial buildings which are at least 30 years old.

Capital gains taxation

Noncorporate taxpayers deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. Corporate taxpayers compute their tax liability using a 28 percent alternative rate applied to net capital gain, if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Net operating loss carryovers

Under present law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 15 years and thus may be deducted from income attributable to other taxable years within this period.

Industrial development bonds

Although interest on State and local bonds used to finance trade or business activity is generally taxable, various exceptions are provided, including bonds issued in certain "small issues."

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to lighten the regulatory burden on small businesses, small nonprofit organizations, or small governmental jurisdictions.

Foreign trade zones

A foreign trade zone may be established within any port of entry, and for imported goods shipped into a zone, duties are not levied until and unless goods are sent into other United States territory.

Summary of the Bill

Businesses and employers located in an enterprise zone would be entitled to various tax incentives and special regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated by the Secretary of Housing and Urban Development after competitive review of State and local government nominations. Each nominated zone would have to satisfy various requirements concerning economic, demographic, and physical characteristics. The State and local governments seeking designation of a nominated area as an enterprise zone would be required to commit themselves to specific actions to enhance the development of the area. The Secretary would be required to designate up to 25 areas as enterprise zones in each of three successive years after enactment of the bill. A designation would remain in effect for 24 years, unless a shorter period were requested by the nominating governments, or the Secretary revoked the designation.

Title II. Tax incentive provisions

Tax credits for zone employers

Employers would be allowed two nonrefundable tax credits. First, a credit would be allowed equal to 10 percent of qualified wages in excess of the amount of qualified wages paid in the 12-month period before the area was designated as an enterprise zone. Qualified wages would be wages paid (subject to a limitation) to qualified employees, i.e., individuals 90 percent or more of whose services directly related to the zone business and 50 percent of whose services were performed in the zone. Second, a credit would be available for a portion of wages paid to certain disadvantaged individuals who were qualified employees.

Tax credit for zone employees

Qualified employees, as defined above, would be allowed a nonrefundable tax credit of 5 percent of earnings subject to a maximum.

Investment tax credit for zone property

An additional investment tax credit of from 3 to 10 percent, depending on the type of property, would be allowed for real and personal property used in a trade or business in an enterprise zone.

Elimination of capital gains taxation

Capital gains taxes would be eliminated on all net capital gains on the sale or exchange of property used in an enterprise zone in the active conduct of a trade or business or on an interest in a qualified business. A qualified business would be a person at least 80 percent of whose gross receipts were attributable to the active conduct of a trade or business (including rental of real estate) within an enterprise zone and substantially all the assets of whom are located within a zone. Conforming changes would be made in the minimum tax provisions.

Extension of net operating loss carryover period

A net operating loss attributable to zone business could be carried forward for the remaining life of the zone or 15 years, whichever is longer.

Small issue industrial development bonds

Future legislative restrictions on small issue industrial development bonds generally would not apply to bonds, the proceeds of which are used for property located in a zone.

Tax simplification

The Internal Revenue Service would be required to simplify the administration of tax provisions added by this bill.

Title III. Regulatory flexibility

Upon request, Federal agencies and regulatory bodies could relax any regulatory requirements within zones, except requirements provided by statute or affecting civil rights, safety and public health.

Qualified businesses, any government nominating an area subsequently designated as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as is now given to certain small entities.

Title IV. Foreign trade zones

Whenever possible, foreign trade zones could be established within enterprise zones.

II. DESCRIPTION OF S. 2298

(THE ENTERPRISE ZONE TAX ACT OF 1982)

A. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting economic development within those areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96–499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic economic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Several other provisions of the Code provide special tax treatment for specific areas. Section 4994(e) exempts crude oil produced in certain areas of Alaska from the windfall profit tax. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 50 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puero Rico or the possession.

Explanation of Provisions

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

1. Definition of enterprise zones

An enterprise zone would be any area in the United States or its possessions which is nominated as an enterprise zone by one or more local governments and the government of the State in which it is located, if the Secretary (of Housing and Urban Development) approves the designation. The Secretary could approve the designation only after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration. In the case of an enterprise zone on an Indian reservation, the Secretary of the Interior would have to be consulted.

The term "State" would include the District of Columbia, Puerto tary of the Interior would have to be consulted.

The term "State" would include the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and the possessions of the United States. The term local government would include the city, town, township, parish, village or other form of municipal government when the nominated area is within an incorporated area, and the county government when the nominated zone is within an unincorporated area.

Before designating any area as an enterprise zone, the Secretary of HUD would have to promulgate regulations, drawn up after consultation with the above federal officials, describing (1) the nominating procedures, (2) the size and population characteristics of an enterprise zone, (3) other standards for designation as an enterprise zone to be met by a nominated area, and (4) the procedures for comparing nominated areas using the criteria specified, in items 4 and 5 below, for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

The Secretary could make designations as enterprise zones only during a 36-month period that begins on the earlier of the effective date of the regulations, or January 1, 1983. During each of the three 12-month periods, not more than 25 nominated areas could be designated as enterprise zones.

The Secretary could not designate an area as an enterprise zone until he had received assurances that the State and local governments had the authority to make commitments with respect to the zone and that the commitments would be fulfilled. Nominations of an area would have to be submitted in the form and with the information required in the Secretary's regulations. The Secretary also would have to determine that the information submitted with the nomination is reasonably accurate and that no portion of the nominated are already was included in an enterprise zone or an area nominated as an enterprise zone.

A nomination of an area first would have to be made by a local government and followed by a confirming nomination by the State gov-

ernment, or vice versa. In the case of a nomination of an area on an Indian reservation to be an enterprise zone, the reservation governing body, as determined by the Secretary of the Interior, would be deemed to be both the State and local government for the reservation.

2. Period of effect of designation

Under the bill, any enterprise zone designation would remain in effect from the date of designation to December 31 of the year 24 years later, or to an earlier date stipulated by the State and local governments in their nomination application, or until the revocation of the zone designation by the Secretary. The Secretary could revoke a zone designation if he determined that the State or local government was not complying substantially with the required State or local government commitments.

3. Area requirements

The Secretary could designate an area nominated as an enterprise zone, if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follow:

a. The area would be required to be within the jurisdiction of the government seeking the designation and to have a continuous boundary.

b. The most recent census would have to show that area population is at least 4,000 if the area is included within a standard metropolitan statistical area with 50,000 or more people, or at least 2,500 in areas of smaller population, or the area would have to be entirely within an Indian reservation (as determined by the Secretary of the Interior).

c. The Secretary would have to determine that the area is one of pervasive poverty, unemployment, and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974 as in effect on the date of enactment.[1] (See Appendix for a description of the area eligibility requirements under section 119.)

d. At least one of four additional requirements would have to be satisfied: (1) The average annual rate of unemployment, as determined by the most recently available data from the Bureau of Labor Statistics, would have to be at least 1½ times the average national unemployment rate for the same time period; (2) according to its most the area has a 20 percent or higher poverty rate in each census tract, minor civil division or census county division; (3) at least 70 percent of the households living in the area would have to have income below 80 percent of the median income of the households of the government designating the area (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974); or (4) the population in the area would have to have decreased by 20 percent or more between 1970 and 1980, as derived from census data.

4. Required State and local government commitments

Under the bill, no area would be designated as an enterprise zone unless the local government and the State in which it is located agreed

[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods.

in writing that during any period during which the area was an enterprise zone, these governments would follow a course of action designed to reduce the various burdens borne by employers or employees in the area.

A course of action under the commitment could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. A course of action within the enterprise zone could include (but would not be limited to) (1) a reduction of tax rates or fees, (2) an increase in the level or efficiency of local services or experiments with the supply of these services by nongovernmental entities, (3) elimination, reduction or simplification of government requirements, and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly from within the nominated zone, including a commitment from these private entities to provide technical, financial, or other assistance to, and jobs or job training for, employees and residents of the area.

5. Priority of designation

The bill would provide criteria for the Secretary to use in evaluating the qualification of areas nominated to be enterprise zones. The Secretary would be required to give special preference to those nominated areas to which the strongest and highest quality commitments, discussed in item 4 above, have been promised, taking into account the fiscal ability of the nominating governments to provide tax relief. During the evaluation of nominated areas, the Secretary would be required to give a higher evaluation to nominated areas with the following additional characteristics: (1) strongest and highest quality contributions in addition to commitments under 4 above; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action would actually be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly those in proximity to concentrations of disadvantaged workers or long-term unemployed individuals and strong likelihood that zone residents who satisfy these criteria would receive jobs in the zone; (4) zone size and location that would stimulate primarily new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibit such other factors, to be determined by the Secretary, that would be consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

6. Interaction with other Federal programs

a. General revenue sharing

Present Law

The general revenue sharing program, as authorized by the State and Local Fiscal Assistance Amendments of 1980 (P.L. 96-604), provides payments to local governments, on an entitlement basis, of $4.6 billion in both fiscal year 1982 and fiscal year 1983. Payments to State

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governments are authorized for these years, but are limited to the amount of categorical grant assistance that a State returns to the Federal Government. No funds have been appropriated under these State government authorizations and no regulations have been issued establishing procedures for returning grant funds to the Federal Government. Subject to few restrictions, State and local governments may use the funds for any purpose they deem appropriate.

The allocation of funds among State and local governments under the general revenue sharing program is determined under formulas which take into account several characteristics of the areas. These include population, urbanized population, per capita income, education spending, intergovernmental transfers, inome tax collections, and total tax collections.

Explanation of Provision

Any reduction of taxes under any required program of local commitment under the enterprise zone program would be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

b. Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970

Present Law

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (P.L. 91–646) governs the responsibilities of Federal agencies which displace residents, businesses and farms because of an acquisition of real property or a requirement that property be vacated which is attributable to Federal or federally assisted projects or programs. Various forms of relocation assistance are provided under the Act. This assistance includes moving expenses, reimbursement of business losses, advisory services, and partial payments for or, under certain circumstances, actual provision of, replacement housing.

Explanation of Provision

Designation of an enterprise zone would not constitute approval of a Federal or federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. No person displaced from real property located in an area designated as an enterprise zone would have any rights or be entitled to any benefit pursuant to that Act as a result of such designation.

B. Tax Incentive Provisions (Title II of the Bill)

1. Tax credits for employers

a. Credit for increased zone employment

Prior Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees or his change in employment. However, a provision in effect in recent years did provide a credit which varied with an employer's increased employment.

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit was 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee.[1] The employer's deduction for wages was reduced by the amount of credit.

The total amount of the credit had four limitations: (1) the credit could not be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year, (2) the credit could be no more than 25 percent of the current year's FUTA wages, (3) the credit for a year could not exceed $100,000, and (4) the credit could not exceed the taxpayer's tax liability. Credits which exceeded tax liability for a year could be carried back for 3 years and carried forward for 7 years.

Although most employers were able to use the returns they filed for purposes of complying with FUTA as a basis for claiming the credit, special rules were provided for businesses, such as farms and railroads, not covered under FUTA. Special rules also were provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form. Additional rules were provided for allocating the credit among members of a partnership and of a subchapter S corporation.

Explanation of Provision

Under the bill, employers would be permitted to claim a nonrefundcurred during the taxable year. In general, "qualified wages" would be able tax credit equal to 10 percent of "qualified wages" paid or inployees in excess of the qualified wages paid by that employer during the 12 calendar month period prior to enterprise zone designation

[1] For 1978, the FUTA base went up to $6,000. In order to make the 1978 wage base comparable with 1977 for purposes of the jobs credit, only the first $4,200 of the FUTA wage base for each employee was included in the computation.

(base period wages). If an employer was not engaged in an active trade or business in the area during that 12-month period, then base period wages would be zero.

Under the bill, a qualified employee would be any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in an enterprise zone and who performs at least 50 percent of his service for the employer in an enterprise zone. A qualified employee would not include an employee with respect to whom the employer claimed a WIN [2] or targeted jobs credit.

Qualified wages for any employee could not exceed 2½ times the FUTA wage base (currently $6,000) in effect in any taxable year. Further, qualified wages would have to be reduced by any amount of federally funded on-the-job training payments the employer receives or is entitled to receive for such individual for that period and by any amount claimed as a credit under the qualified disadvantaged individual credit discussed below.

The increased enterprise zone employment credit would be phased out starting in the taxable year of the taxpayer in which falls the twenty-first anniversary of the enterprise zone designation, when the credit would be reduced to 7½ percent of qualified wages. The credit would then be reduced by 2½ percentage points for each succeeding year until fully terminated.

Rules analogous to those contained in the present targeted jobs credit would control allocation of the credit among commonly controlled corporations and other business entities. Special rules would also apply to allocate the credit between subchapter S corporations and their shareholders, and estates and trusts and their beneficiaries. Finally, special rules would apply to allocate "base period wage" amounts between persons acquiring and disposing of major portions of a trade or business or of a separate unit of a trade or business.

The allowable amount of the credit would be limited to the taxpayer's tax liability, but unused credits could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to qualified increased employment expenditures made after the date of an area's designation as an enterprise zone.

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[2] The WIN credit does not apply to amounts paid or incurred in taxable years beginning after 1981. AFDC recipients and WIN registrants, formerly eligible for the WIN credit, are now a targeted group for purposes of the targeted jobs credit.

b. Credit for zone employment of disadvantaged individuals

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of the employees. However, the targeted jobs tax credit does allow a credit against tax for a portion of wage payments made to certain types of employees.

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for the employer before January 1, 1983, is available on an elective basis for hiring individuals from one or more of nine target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 to 25; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) involuntarily terminated CETA employees.

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that are members of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships, and other trades or business (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Explanation of Provision

General

Under the bill, employers also would be entitled to a credit with respect to qualified wages paid to certain "qualified disadvantaged individuals" (*i.e.*, employees in certain specified categories). In general, for purposes of this credit, "qualified wages" would be all wages paid or incurred by an employer during the taxable year for employment of qualified disadvantaged individuals, reduced by the amount of any federally funded payments the employer receives or is entitled to receive for on-the-job training for such individuals for the taxable year. There would be no dollar limitation on wages eligible for the credit.

This credit would be allowable for a total of seven years with respect to any qualified employee. The credit would be 50 percent of qualified wages received by a qualified disadvantaged individual during the 36-month period beginning the day the individual began work in an enterprise zone for an employer. The credit would then be reduced 10 percentage points during each of the succeeding twelve-month periods: to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. These time periods would not take into account any period of time during which the individual is unemployed. The credit with respect to any one employee would be terminated after the seventh year of employment.

Categories eligible for the credit

A qualified disadvantaged individual would be any individual who is hired after the designation of an area as an enterprise zone, and who would be an eligible employee under the increased enterprise zone employment credit (i.e., who performs 90 percent or more of his services for the enterprise zone business and 50 percent or more of his services in the enterprise zone). Furthermore, a qualified disadvantaged employee would have to fall into at least one of seven categories of disadvantaged individuals: (1) vocational rehabilitation referrals, (2) economically disadvantaged individuals, (3) eligible foster children, (4) SSI recipients, (5) general assistance recipients, (6) eligible handicapped individuals, and (7) eligible AFDC recipients.

Four of the seven categories, (1) vocational rehabilitation referrals, (2) SSI recipients, (3) general assistance recipients, and (4) eligible AFDC recipients, are similar to targeted groups presently contained in the targeted jobs credit. The other categories are defined in the bill as follows:

Economically disadvantaged individuals.—An economically disadvantaged individual would be defined as an individual who is certified by the designated local agency as being a member of a family that had an income during the 6 months prior to the determination month which, if annualized, was equal to or less than the AFDC and food stamp benefits available to a family with no income.

Foster children.—Foster children would be individuals certified by the designated local agency as receiving State or local government benefits under a program to assist foster children.

Handicapped individuals.—Handicapped individuals would be individuals who, pursuant to regulations issued by the Secretary, are certified by the designated local agency as either disabled and living at home, or institutionalized or receiving the services in (or of) a sheltered workshop, prison, hospital, or other similar institution.

Other rules

Rules analogous to those contained in the present targeted jobs credit would control certification procedures and allocation of the credit among controlled businesses, between subchapter S corporations and their shareholders, and between estate and trusts and their beneficiaries.

Any credit taken with respect to an employee would be recaptured if the employee were terminated at any time during the first 270 days of employment, or before the close of 270 calendar days after the 90th day of employment, with certain exceptions, including voluntary termination. However, if the major portion of a trade or business, or the major portion of a separate unit of a trade or business of an employer were acquired by another employer, then employment of any qualified employee would not be terminated for purposes of this credit if the employee continued to be employed in that trade or business.

This credit would be phased out by 25 percent per year starting in the taxable year of the taxpayer in which the twenty-first anniversary of zone designation falls. No deduction would be allowable to an enterprise zone employer for that portion of wages paid or incurred for the taxable year equal to the amount of credits allowable under either the increased enterprise zone employment credit or the economically disadvantaged individual credit allowable for the taxable year.

The allowable amount of the credit would be limited to the taxpayer's tax liability, but unused credits could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

These provisions would apply to wages paid after the date of an area's designation as an enterprise zone.

2. Tax credit for zone employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of his employment. However, a refundable credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit, taxpayers living with children in the United States are eligible for a refundable tax credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The maximum credit is reduced by 12.5 percent of the taxpayer's adjusted gross income (or if greater, earned income) in excess of $6,000. Thus, no credit is available to taxpayers with incomes of $10,000 or more.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a nonrefundable tax credit equal to 5 percent of qualified wages for the taxable year. For purposes of this credit, qualified wages would be equal to all remuneration paid for services of a qualified employee, but not including any compensation received from the Federal Government or any State or subdivision of a State, up to 1½ times the wage base in effect for the purpose of the Federal Unemployment Tax Act (FUTA) (currently $6,000). Thus, the maximum credit for any taxable year until the FUTA base is changed would be 5 percent of $9,000 or $450.

For purposes of this credit, a qualified employee would be an individual at least 90 percent of whose services are directly related to an enterprise zone trade or business and at least 50 percent of whose services are performed in an enterprise zone, and who is not an employee of the Federal Government or any State or local subdivision of any State. The determination of whether an individual was a qualified employee would be made separately with respect to each of the individual's employers.

The credit would phase out starting in the taxable year of the employee in which fell the twenty-first anniversary of enterprise zone designation and would be phased out completely in four years.

Employers would be required to report to qualified employees the amount of wages paid to such employees.

Effective Date

These provisions would be effective with respect to taxable years ending after the date of an area's designation as an enterprise zone.

3. Investment tax credit for zone property

Present Law

Under existing law, a regular investment tax credit is allowed for investment in tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, or certain other activities. For eligible property in the 3-year recovery class, a 6-percent regular credit is allowed. For other eligible property, a 10-percent regular credit is allowed.

Buildings and their structural components (other than elevators and escalators) generally do not qualify for the regular investment credit. However, in the case of qualified rehabilitation expenditures, a 15-percent credit is allowed for nonresidential buildings at least 30 years old, a 20-percent credit is allowed for nonresidential buildings at least 40 years old, and a 25-percent credit is allowed for certified historic buildings. The basis of the asset, for such purposes as capital cost recovery deductions, is reduced by the amount of the 15-percent or 20-percent credit. The rehabilitation credit is allowed in lieu of any regular or energy credit that is otherwise allowable. Unused investment credits may be carried forward for 15 years.

Explanation of Provision

Under the bill, an additional investment tax credit would be allowed for capital investments in an enterprise zone.

Zone personnel property

In the case of property eligible for the regular investment tax credit (other than elevators and escalators), an additional 3-percent credit would be available for 3-year recovery property and an additional 5-percent credit would be available for 5-year property, 10-year property, and 15-year public utility property. In order to be eligible for this additional credit, such property would have to be acquired and first placed in service by the taxpayer in an enterprise zone after designation of the zone. In addition, the taxpayer would have to use the property predominantly in the active conduct of a trade or business within an enterprise zone. Property used or located outside the enterprise zone on a regular basis would not be eligible for the additional credit.

New zone construction property

An additional 10-percent tax credit would be available for 15-year real property (including lodging, elevators and escalators) located in an enterprise zone if the property is acquired or constructed by the taxpayer and used predominantly in the active conduct of a trade or business within the enterprise zone. In the case of property acquired by the taxpayer, the additional credit would be available only if the

property was acquired after designation of the zone and only if the original use of the property commenced with the taxpayer. In the case of property constructed, reconstructed, rehabilitated, renovated, expanded, or erected by the taxpayer, the credit would be available only to the extent of any construction or erection after designation of the enterprise zone.

For property eligible for this additional 10-percent tax credit (15-year real property), the basis of the property would be reduced by the amount of the additional credit allowable.

Recapture

If property for which an enterprise zone credit was claimed by a taxpayer ceases to be enterprise zone property of the taxpayer (other than by expiration or revocation of the designation of the zone), a portion of the enterprise zone credit would be recaptured. Property would cease to be enterprise zone property of a taxpayer if, for example, the taxpayer disposed of the property, removed the property from the enterprise zone, or ceased to use the property in the active conduct of a trade or business within the enterprise zone.

The amount of the enterprise zone credit subject to recapture would be the difference between the amount of credit allowed for the property and a recomputed credit based on the amount of time the property was enterprise zone property of the taxpayer. The recomputed credit would bear the same ratio to the amount of credit originally allowed as the number of taxable years in which the property was enterprise zone property of the taxpayer bears to the number of years over which the property is depreciated for purposes of computing earnings and profits. The recapture periods would be as follows:

	Years
3-year property	5
5-year property	12
10-year property	25
15-year public utility property	35
15-year real property	35

Thus, for example, no enterprise zone credit would be recaptured with respect to 3-year recovery if it remained enterprise zone property of the taxpayer for 5 taxable years. If this property had been enterprise zone property of the taxpayer for only 4 taxable years, 20 percent of the enterprise zone credit would be recaptured.

Carryover period

Unused investment tax credit amounts attributable to the additional enterprise zone percentage could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to qualified expenditures made or incurred after the date an area's designation as an enterprise zone.

4. Elimination of capital gains taxation

Present Law

Overview

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means property held by the taxpayer. However, capital assets generally do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, gains from sales or exchanges of certain depreciable or real property used in the taxpayer's trade or business may be treated as capital gains under certain circumstances.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used. In specific instances, however, present law allows nonrecognition, or rollover, of gain or loss from certain property, such as owner-occupied housing, to the extent that the proceeds are reinvested in an approved manner. In addition, present law treats some capital gain as ordinary income to the extent of certain previously taken deductions, e.g., depreciation recapture.

Noncorporate capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a noncorporate taxpayer's entire net capital gain is 20 percent, i.e., 50 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in adjusted gross income.

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax on certain specified tax preference items. Accelerated depreciation on real property is a

tax preference item for all taxpayers. Accelerated depreciation on leased personal property is also a tax preference item for taxpayers, and 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that it exceeds their regular income tax, including the "add-on" minimum tax. The alternative minimum tax is based on the sum of the taxpayer's gross income, reduced by allowed deductions, and increased by two tax preference items: (1) "excess" itemized deductions and (2) the capital gains deduction. The alternative minimum tax rate is 10 percent for amounts from $20,000 to $60,000 and 20 percent for amounts in excess of $60,000.

Explanation of Provision

Qualified property and qualified business

The bill would provide special tax treatment for gains and losses from sales or exchanges of "qualified property" held for more than one year. For this purpose, the term "qualified property" would mean (1) tangible personal property used predominantly by the taxpayer in an enterprise zone in the active conduct of a trade or business, (2) real property located in an enterprise zone and which is used predominantly by the taxpayer in the active conduct of a trade or business in a zone and (3) an interest in a corporation, partnership, or other entity if, for the three most recent taxable years of the entity ending before the date of disposition of the interest, or for the part of this period, as the entity was in existence (the qualifying period), the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) which is actively engaged in the conduct of a trade or business (including rental of real estate) during the qualifying period, (2) with respect to which at least 80 percent of such person's gross receipts for the taxable year would be attributable to the active conduct of a trade or business within an enterprise zone, and (3) substantially all of the tangible assets of which are located within an enterprise zone.

Under the bill, gain from the sale or exchange of an interest in a qualified business would not be treated as gain from the sale or exchange of qualified property to the extent the gain is attributable to (1) any property contributed to the qualified business within the previous 12 months, (2) any interest in a business which is not a qualified business, or (3) any other intangible property not created as part of an active trade or business within an enterprise zone.

Under the bill, the special tax treatment for gains and losses from sales or exchanges of "qualified property" would not cease to be available subsequent to the termination or revocation of an area's designation as an enterprise zone. However, the special tax treatment would not apply after the first sale or exchange of any item of "qualified property" after the designation of an area as an enterprise zone ceases to apply.

Noncorporate capital gains deduction

The bill would provide a special rule for a noncorporate taxpayer's gains and losses from sales or exchanges of qualified property. Under this rule, a noncorporate taxpayer could deduct from gross income an amount equal to the sum of (1) 100 percent of the lesser of the taxpayer's net capital gain, or the net capital gain taking into account only sales or exchanges of qualified property, plus (2) 60 percent of the excess (if any) of the net capital gain over the amount of the net capital gain subject to the 100 percent deduction. This rule, in effect, would allow a noncorporate taxpayer to deduct from gross income 100 percent of any net capital gain from qualified property.

Corporate capital gains tax

The bill would allow a corporation to exclude from taxation net capital gains from qualified property.

Minimum taxes

The bill would eliminate the classification of net capital gains from qualified property as a tax preference item for purposes of the minimum taxes.

Effective Date

These provisions would apply to sales or exchanges after an area's designation as an enterprise zone.

5. Extension of net operating loss carryover period

Present Law

Under existing law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 15 years and thus may be deducted from income attributable to the other taxable years within this period.

Explanation of Provision

For any taxable year during which a taxpayer conducts an active trade or business within an enterprise zone, the bill provides that a net operating loss attributable to such a business could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to net operating losses in taxable years ending after the date of an area's designation as an enterprise zone.

6. Small issue industrial development bonds

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax. However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable. An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization described in sec. 501(c)(3)[1] and (2) payment of principal or interest on which is secured by an interest in, or derived from payments with respect to, property or borrowed money used, or to be used in a trade or business.

Present law provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of exempt small issues) made over or a six-year period[2] does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

Explanation of Provision

The bill generally provides that the tax provisions applicable to small issue industrial development bonds, as in effect on January 1, 1982, would apply to obligations the major portion of the proceeds of which are to be used directly for any land or depreciable property that is located in an enterprise zone. The only amendments that would

[1] For example, interest on an obligation the proceeds of which are to be used in the trade or business which is not an unrelated trade or business, of a charitable organization, is exempt from tax.

[2] The relevant six-year period is the period beginning three years before the date of issue and ending three years after that date. For issues used for projects which receive UDAG grants, up to $10 million of capital expenditures is exempt from the $10 million limitation.

be given effect with respect to those obligations would be amendments relating to arbitrage or to registration of such obligations.[3]

Effective Date

This provision would apply only with respect to obligations that are issued after the date an area is designated as an enterprise zone and before the designation terminates, provided that the proceeds are used prior to the date the area ceases to be an enterprise zone.

[3] As part of its fiscal year 1983 budget proposals, the Administration has proposed new restrictions on the issuance of private purpose tax-exempt bonds, reduction of the benefit from tax-exempt bonds by requiring an election between tax-exempt financing and the accelerated cost recovery system, and limitation of the use of small-issue bonds to small businesses. Other parts of the proposal would provide restrictions relating to arbitrage and would require private purpose tax-exempt bonds to be in registered form.

7. Tax simplification

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

Effective Date

The provision would be effective upon enactment.

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[1] Sec. 507 of P.L. 94–455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95–600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simplification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD–78–74; July 5, 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

C. Regulatory Flexibility (Title III of the Bill)

Present Law

The Regulatory Flexibility Act (5 USC secs. 602–612) requires Federal regulatory agencies to publish analyses of the economic impact on entities under its coverage of any proposed regulations and to discuss alternatives to those regulations. The Act requires Federal regulatory agencies to undertake a periodic review of their regulations to determine whether they should be changed to minimize their economic impact on the entities covered by the Act.

In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provision

Under the bill, Federal agencies and regulatory bodies would be given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, such as the Davis-Bacon Act or the Fair Labor Standards Act. This authority could be exercised only upon request of State and local governments.[1]

The bill also would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within an enterprise zone.

The bill also would provide that the Secretary of Housing and Urban Development would be required to promote the coordination of programs under his jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

[1] Examples of regulations which could be relaxed include regulations governing exports, regulations affecting accounting treatment of loans made by national banks, regulations affecting inventory accounting for tax purposes, regulations affecting issuance of securities, and regulations affecting various energy performance, coal conversion, and conservation regulations.

D. Establishment of Foreign Trade Zones in Enterprise Zones (Title IV of the Bill)

Present Law

Under present law, each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, foreign merchandise may be received by a company, and the merchandise is not considered to have entered U.S. Customs territory. Thus, dutiable goods may be received free of duty. These goods may be stored, sold, repaired, assembled, distributed, manufactured and displayed within the zone, and then exported or sent into Customs territory of the United States. When sent into Customs territory they become subject to the laws affecting imported merchandise, such as the levy of customs duties.

Foreign trade zones are authorized by the Foreign Trade Zone Board, a Federal agency chaired by the Secretary of Commerce. Such zones typically consist of specific factories, warehouses, or industrial parks.

Explanation of Provision

The bill would require that the Foreign Trade Zone Board should expedite the processing and approval to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an enterprise zone. The Secretary of the Treasury would be required to give similar consideration to an application for establishment of a port of entry necessary to permit the establishment of a foreign trade zone within an enterprise zone.

III. REVENUE EFFECTS OF THE BILL

The Treasury Department estimates that the bill would reduce fiscal year receipts by $0.1 billion in 1983, $0.4 billion in 1984, $0.8 billion in 1985, $1.0 billion in 1986, and $1.3 billion in 1987. However, for several reasons, these figures may either underestimate or overestimate the actual revenue loss by a considerable degree.

Treasury's estimates are based on the assumption that the zones selected by the Secretary of Housing and Urban Development would have, at the time of designation, average employment of 10,000 and a mix of economic activities similar to those of a sample of distressed areas in several large cities. The language of the bill does not require this average employment and economic mix, however, so that the above figures may not estimate the actual revenue loss. If the average zone has, for example, only 5,000 employees, then actual revenue losses would be $0.05 billion, $0.2 billion, $0.4 billion, $0.5 billion, and $0.7 billion in fiscal years 1983 through 1987, respectively, if the assumptions about the economic mix were correct.

On the other hand, several factors could make the actual revenue loss higher than the Treasury estimates. First, because of data limitations, the Treasury estimates do not take account of losses associated with investments in rental housing and other rental real estate, investments by public utilities, and the revenue loss associated with the capital gains provisions in the bill. Second, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed. Finally, the average size of zones when they are actually designated by the Secretary could be much larger than 10,000. If, for example, employment in designated zones were to average 50,000, fiscal year revenue losses would be $0.5 billion in 1983, $2.0 billion in 1984, $4.0 billion in 1985, $5.0 billion in 1986, and $6.5 billion in 1987.

APPENDIX

Area Eligibility Criteria for Urban Development Action Grants (UDAG)

The Urban Development Action Grant (UDAG) program provides grants for economic revitalization and neighborhood reclamation projects. The projects must be located in jurisdictions or areas which meet certain minimum standards of physical and economic distress and which demonstrate provision of housing for low and moderate income individuals and equal opportunity in housing and employment. Currently, more than 350 cities of population over 50,000 and more than 10,000 smaller cities are eligible for UDAG grants, either in whole or in part.

Area eligibility factors

The statute authorizing the program specifies six factors to be taken into account in determining an area's eligibility, and the Secretary of Housing and Urban Development provides by regulation the numerical levels of these factors which are required for eligibility. The six factors currently in effect are as follows:

a. Poverty rate.—At least 10.92 percent of the population of the jurisdiction have incomes at or below the poverty level, based on 1970 Census data.

b. Age of housing.—At least 33.38 percent of the jurisdiction's year-round housing units were constructed prior to 1940, based on U.S. Census data.

c. Growth in per capita income.—The net increase in per capita income for the period 1969 to 1977 must have been $2,694 or less, based on U.S. Census data.

d. Population growth.—For the period 1960–1978, the population growth must have been 0.2 percent or less in cities of under 50,000 population, or 17.78 percent or less in larger cities or urban counties.

e. Employment growth in retailing and manufacturing.—The rate of growth in retail and manufacturing employment for the period 1972 to 1977 must have been 6.74 percent or less.

f. Unemployment rate.—The 1979 unemployment rate must have been at least 5.64 percent, based on Bureau of Labor Statistics data.

Population criteria

Eligibility of areas depends on their population:

1. Cities over 50,000.—Cities and urban counties with a population of at least 50,000 must meet at least three of the above six criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet at least four of the remaining five criteria.

2. Cities of population between 25,000 and 50,000.—Cities with population between 25,000 and 50,000 must meet at least three of the

first five criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet all four of criteria (b) through (e), above. If the poverty rate is at least double the figure above (item (a)), the city must also meet only one of the criteria (b) through (e), above. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

3. Cities of population under 25,000.—A city under 25,000 must meet three of the first four criteria (items (a) through (d)). If the poverty rate is at least double the figure in item (a) above, then the city must meet only one of the other three criteria. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

4. Areas within ineligible cities.—Severely distressed areas within otherwise ineligible communities may be designated as "pockets of poverty" and thus made eligible. The area must be composed of contiguous census tracts, enumeration districts or block groups. In cities of population over 50,000, the area must contain the lower of 10,000 persons or 10 percent of the jurisdiction's population. For smaller cities, the area must contain the greater of 2,500 persons or 10 percent of the jurisdiction's population. For all cities, no enumeration district or block group with a median income level greater than 120 percent of the jurisdiction's median income may be included in the pocket of poverty. In addition, at least 70 percent of the families and unrelated individuals in the area must have incomes below 80 percent of the jurisdiction's median income, and at least 30 percent of area residents must have incomes below the poverty level.

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